



INDONESIA: ECONOMIC AND FINANCIAL HIGHLIGHTS SEPTEMBER 2005

Summary:

- Sharp increases in clothing, tobacco, and educational costs lifted year-on-year (YoY) consumer price inflation to 9.1% in September 2005, higher than expected.
- Market sentiment improved markedly in September 2005, with the rupiah/USD exchange rate and the Jakarta Stock Exchange strengthening.
- Bank Indonesia (BI) raised short-term interest rates 50 basis points on September 6 in response to Rp/USD weakness and rising inflation expectations.
- Rising interest rates sparked another wave of redemptions of fixed-income mutual funds in September 2005, with the total value of all funds dropping almost Rp 40 trillion (USD 3.9 billion) during the month.
- Indonesia's foreign exchange (FX) reserves continued to drop in September 2005, and have declined by more than 20% since April 2005.
- The Government of Indonesia (GOI) issued Rp 1 trillion (USD 97.2 million) in five-year bonds on September 27.
- The state-owned Asset Management Company (PPA) sold its remaining 5.02% stake in Bank Central Asia (BCA) on September 21, raising Rp 2.2 trillion (USD 212.8 million). Parliament approved a second revision to the 2005 budget on September 20.
- The "Indonesian Deposit Insurance Agency" (LPS) began operations on September 22, and the GOI removed inter-bank loans from coverage under its blanket guarantee on bank third-party liabilities the same day.
- The International Finance Corporation (IFC) again gave Indonesia poor rankings for its business climate in its "Doing Business in 2006" report released on September 14.

Inflation Is Higher Than Expected

On October 3, the Central Bureau of Statistics (BPS) announced that YoY consumer price inflation rose to 9.1% in September 2005. Month-on-month CPI inflation rose to 0.7%. Education, clothing, and tobacco prices rose the most sharply. In response to an average 126% increase in domestic fuel price hikes on October 1, CPI inflation is expected to surge in October.

CPI Components

Components	YoY	MoM
Food stuff	11.46	0.41
Food, beverages, tobacco, cigarettes	9.28	1.16
Housing, water, electricity, oil/gas	6.55	0.48
Clothing	6.38	1.18
Health	5.01	0.86
Education, recreation, and sport	7.89	1.43
Transportation, communication, financial services	12.59	0.41
TOTAL	9.06	0.69

Source: Central Bureau of Statistics

Market Sentiment Improves

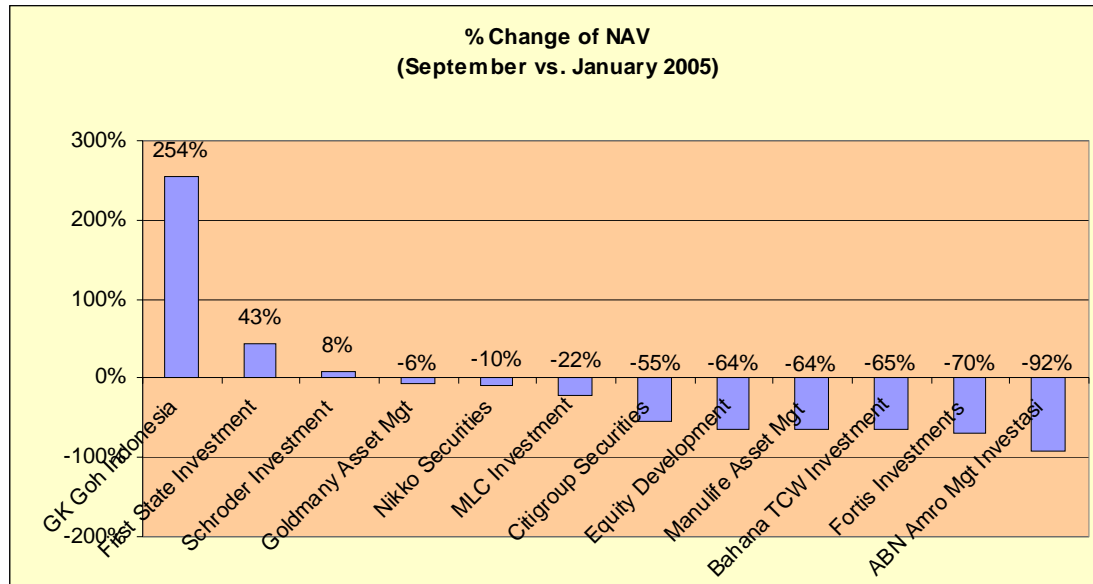
The Rp/USD exchange rate and Jakarta Stock Exchange (JSX) steadied in September in response to BI interest rate hikes and statements by the GOI that it would raise fuel prices. The JSX composite index closed at 1,079 on September 30, up 8% from its August 29 low. The rupiah ended the month at 10,290/USD, an appreciation of six percent from its August 29 low of Rp 10,876/USD. An upbeat statement by the Asian Development Bank (ADB) projecting full-year 2005 GDP growth at 5.7% also boosted market sentiment, as did a statement by the Fitch ratings agency that it saw no need to revise Indonesia's rating as a result of August's rupiah volatility.

Bank Indonesia raised its benchmark one-month Bank Indonesia certificate (SBI) interest rate for the second time in a week on September 7, raising it to 10% from 9.5% the previous week. The bank also introduced a series of measures to curb currency speculation, banning margin trading in foreign exchange starting September 15. The one-month SBI remained at 9.5 for the remainder of September.

Mutual Funds Redemptions Increase

Sharply rising interest rates in August-September sparked another large-scale redemption in mutual funds, as investors retreated from declining fund values and lost their trust in fund managers for failing to disclose the interest rate risk inherent in fixed income investments. Fixed income investments dominate mutual funds in Indonesia. Redemptions surged in the first week of September 2005 to Rp 9 trillion (USD 874.6 million) after BI raised interest rates 75 bps on August 30. U.S. dollar mutual funds also showed a significant downturn, with net asset value declining by USD 97 million, from USD 321 million on June to USD 224 million on September. The mutual fund industry's total NAV dropped to Rp 35 trillion (USD 3.4 billion) in the fourth week of September. Although BAPEPAM has issued regulations requiring investment houses to mark their funds to market, many Indonesian fund managers have been reluctant to do so for fear that declining fund values would drive away customers.

Changes in Mutual Funds NAV (January – September 2005)



Source: BAPEPAM

FX Reserves Continue to Drop

Indonesia's foreign exchange (FX) reserves fell to USD 30.3 billion in the fourth week of September from USD 31.2 billion a month earlier, according to BI data. Indonesia's reserves have dropped by 20% since April, but remain sufficient to cover approximately six months of imports. In early September, the GOI converted USD 400 million of its savings at BI to rupiah. Director General for the State Treasury in the Ministry of Finance (MOF) Mulia Nasution told the press "the government is not looking for a capital gain, we simply want to reduce pressure on the rupiah." Nasution added that the MOF would conduct similar operations "in the near future if needed," up to a maximum of USD 1 billion. In addition to U.S. dollar savings, the GOI keeps approximately Rp 70 trillion (USD 6.8 billion) in accounts from various sources at BI.

GOI Sells Rupiah Bonds

Citing allegedly questionable debt management, on September 12 Parliamentary Commission XI asked the GOI to hold off on further bond issues or buybacks until it has discussed a comprehensive debt strategy for the country. Despite the Parliament's objection, the Ministry of Finance sold Rp 1 trillion (USD 97.2 million) of five-year rupiah bonds on September 27 yielding 15.1%. On September 7, the MoF also bought back Rp 944 billion (USD 91.7 million) of high-yield bonds maturing in 2006 and 2007.

Analysts noted the MOF may be trying to reduce the amount of maturing debt in 2006 and 2007, when the GOI faces heavy amortizations.

Government Sells Remaining Stake in BCA

On September 21, the government sold its remaining 5.02% stake in Bank Central Asia (BCA), the country's second largest lender by assets, for Rp 2.19 trillion (USD 212.8 million). PPA President Director Mohammad Syahril told the press that the agency sold its BCA shares for Rp 3,550 a share, a 2% premium on the shares' closing price on September 20. Proceeds from the sale will count toward the GOI's Rp 4 trillion (USD 389 million) privatization target in the 2005 budget. PPA Deputy President Director Raden Pardede said that foreign investors purchased "almost all, 99.7%" of the shares. The U.S. hedge fund Farallon Capital Management LLC, currently controls 52% of BCA. Farallon bought a 30% stake in BCA for Rp 5.37 trillion (USD 521.9 million) in March 2002 before raising its stake to 52% in February 2004. The September 21 sale was the second time this year the GOI has attempted to sell its stake in BCA--a March 23 tender offer drew a weak response.

Parliament Approves Final 2005 Budget

After weeks of debate, Parliament finally approved a second and final revision of 2005 budget on September 20. In a September 27 plenary session, a majority of lawmakers supported the GOI's plan to raise fuel prices to limit fuel subsidy spending in 2005 to Rp 89.2 trillion (USD 8.7 billion). Only the opposition Indonesian Democratic Party of Struggle (PDI-P) voted against the price hikes. The United Development Party (PPP) opposed the price hikes, but voted for the budget revision. Without the price hikes, the MOF estimated that full year fuel subsidy spending would have reached Rp 113.7 trillion (USD 11.0 billion). A first revision of the budget passed on June 29 containing funds for emergency relief for the December 26, 2004 earthquake and tsunami, the creation of an Aceh reconstruction agency, and local elections.

GOI Unveils Fuel Price Compensation Programs

The GOI also unveiled a package of compensation measures in September 2005 designed to reduce the impact of the price hikes on the poorest Indonesians. The key measure is an unprecedented, Rp 5 trillion (USD 490 million) cash transfer program that will provide a temporary cushion for needy families for twelve months. Indonesia's 15.5 million poorest households (benefiting 65 million people) will receive Rp 300,000 (USD 29) in cash every quarter for the next 12 months, with the next payout to be in January. The Ministry of Finance will transfer funds to branches of Bank Rakyat Indonesia, which will then pass them to local post offices. Qualified families who have met 14 variables designated by the Central Bureau of Statistics (BPS) will then be required to show identification at the post office to receive payment. GOI officials say they will prioritize 15 large cities for the transfer program, and that as of October 3, have already completed approximately 40% of the initial quarterly payments.

In addition to the cash transfer program, the GOI plans to disburse approximately Rp 13.5 trillion (USD 1.3 billion) in 2005 through three additional programs targeting the social needs of poorer Indonesians:

- A Rp 6.3 trillion (USD 617 million) block grant program to participating primary and junior secondary schools designed to both raise the quality of education, as well as reduce contributions by pupils identified as poor.
- A Rp 3.9 trillion (USD 382 million) basic health care program that will provide free health care services to everyone at public health clinics and free in-patient treatment at third class hospitals for the poor.
- A Rp 3.3 trillion (USD 323 million) rural infrastructure program under which more than 12,000 villages will receive Rp 250 million (USD 24,500) each for the construction of roads, bridges, and other village-level infrastructure facilities.

Deposit Insurance Scheme Starts Operation

The MOF announced on September 27 the Board of Commissioners for the Indonesian Deposit Insurance Corporation (LPS), which opened its doors on September 22. The new LPS President Commissioner is Rudjito, former President Director of state-owned BRI. The Executive Board Director is Krisna Wijaya, a former commissioner at BRI. All foreign and domestic banks are obligated to pay LPS insurance premiums of 0.1% of deposits twice a year, along with a participation fee of 0.1% of bank capital.

The creation of the LPS is the first step in a planned gradual rollback of the blanket government guarantee on bank third party liabilities in place since the 1997-98 financial crisis. Concomitant with the start-up of the LPS, the GOI also eliminated the blanket guarantee on inter-bank loans. The GOI plans a phased rollback of the blanked guarantee for deposits according to the following schedule:

Government Blanket Guarantee – Timeline For Rollback

Date	Guarantee Limit
Sept 22, 2005 – March 21, 2006	All deposits 100% guaranteed, excluding intra-bank lending
March 22, 2006	Rp 5 billion (USD 486,000)
Sept 22, 2006	Rp 1 billion (USD 97,000)
March 22, 2007 (final)	Rp 100 million (USD 9,700)

Source: Investor Daily

IFC Plans to Invest in Banking Sector

On September 13, International Finance Corporation (IFC) released its “Doing Business in 2006” report. The report ranks Indonesia 113 out of 155 countries in terms of doing business conditions, lagging far behind its regional peers such as Vietnam, China,

Malaysia, Thailand, and Singapore. During the launching, the IFC also announced a plan to invest USD 100–125 million in Indonesia’s banking sector. The IFC also said it would contribute USD 30,000 for 27 rural development banks to develop an online customer information network.

Selected Economic, Monetary & Financial Statistics

	Jun 05	Jul 05	Aug 05	Sep 05
CPI Inflation (YoY)	7.42	7.84	8.33	9.06
CPI Inflation (MoM)	0.50	0.78	0.55	0.69
Rp/USD Exchange rate ¹	9,713	9,819	10,350	10,290
30-day SBI Interest Rate ²	8.25	8.49	9.51	10.00
Foreign reserves ³	33.86	32.10	32.02	31.20
JSX Composite Index	1122.4	1182.3	1050.1	1079.3
JSX Trans Volume ⁴	1,209	1,657	1,958	
Exports (USD billion)	6.73	6.99	7.03	
% Change (YoY)	27.48	25.85	23.94	
Import (USD billion)	4.72	4.82	5.40	
% Change (YoY)	35.35	31.89	32.22	
Trade Balance ⁵	2.01	2.17	1.63	

Source: Bank Indonesia, BPS

(1) Rp/USD, end of period

(2) End of period

(3) USD billions, end of period

(4) Jakarta Stock Exchange average daily transaction volume, in billions of shares

(5) USD billions

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